

DEPARTMENT OF CORPORATIONS
California's Investment and Financing Authority**M E M O R A N D U M**

DATE: June 6, 2008

TO: Dale E. Bonner, Secretary
Business Transportation & Housing

FROM: Preston P. DuFauchard, Commissioner
Department of Corporations

SUBJECT: Review of the Systems of Internal Control

In accordance with the Financial Integrity and State Managers Accountability Act of 1983, Government Code Sections 13400 through 13407, I am submitting the enclosed report describing the review of our systems of internal control for the biennial period ended December 31, 2007.

As statutorily required, The Department of Corporations (DOC) is in compliance with Government Code Section 12439 by continuously participating in statewide job fairs and various recruitment activities assisting managers/supervisors in their hiring process. In addition, DOC is streamlining the recruitment/selection process by administering examinations for hard to recruit classes on a quarterly basis and utilizing appropriate lists from other departments who examine on a continuous basis.

Enclosure(s)

cc: Michael Tritz, Deputy Secretary
Business, Transportation & Housing

Beverly England, Staff Management Auditor
Business, Transportation & Housing

Department of Finance
Office of State Audits & Evaluations

Michele Bond, Acting Chief Deputy &
Deputy Commissioner Office of Management & Budgets

Department of Corporations
Financial Integrity and State Manager's Accountability Act Report
For the Period Ending December 31, 2007

The Financial Integrity and State Manager's Accountability Act of 1983 (FISMA) provides a board view of internal accounting and administrative control, recognizes that controls must safeguard assets, provide accurate and reliable financial information, promote operational efficiency, and encourage adherence to office policies and procedures. FISMA also states that the elements of satisfactory internal accounting and administrative control will include, but not limited to the following:

- A plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.
- A plan that limits the access of state assets to authorized personnel who require these assets in the performance of their assigned duties.
- A system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.
- An established system of practices to be followed in the performance of duties and functions in each of the state entities.
- Personnel of a quality commensurate with their responsibilities.
- An effective system of internal review.

The head of state agencies are responsible for establishing and maintaining a system(s) of internal accounting and administrative control within their agencies. This responsibility includes documentation of the system(s), communication of system requirements to employees, assurance that the system is functioning as designed, and modification of the system(s) as changes in conditions warrant.

Effective July 12, 2006, state agencies are required to conduct an internal review and prepare a report on the adequacy of the system(s) of internal control on biennial basis each odd year. This review must be completed in accordance with the guidance prepared by the Department of Finance, Office of State Audits, and Evaluations.

Review Strategy

The Department of Corporations (Department) utilized the two most recent external audit reports issued on the Department as the starting point to assess the risk of our internal and administrative controls. The two were the Department of Finance's audit report issued January 2006 and the Bureau of State Audits' audit report issued January 2007.

Review Methodology

Since the Department does not have an internal audit unit, the Fiscal Manager performed a high-level review of our internal and administrative controls. We created an internal control questionnaire using attachment A and B of the *Guidance for the Evaluation of Internal Control*, prepared by Department of Finance, Office of State Audits and Evaluations, and the external audit findings. Administrative managers were assigned to assess their areas by completing the internal control questionnaire.

The Fiscal Manager reviewed the completed internal control questionnaire responses, compared them to the external audit findings, and discussed any identified discrepancies with the administrative managers. After the discrepancies were resolved, a risk assessment table was prepared using the internal control questionnaires. Based on the risk assessment, the Fiscal Manager determined that the accounting functions had the greatest risk. Specifically, two of the processes implemented in response to the audit findings were not fully resolving the identified issues.

Insufficient Internal Controls

The two deficient internal control areas were the control of cash receipts (to ensure safeguard of state assets and the reliability and integrity of the data), and control of receivables (to ensure the reliability and integrity of the data). Our specific findings are described in the following paragraphs.

Finding 07-1 Control of Cash Receipts (originally DOF Finding 1)

"The checks received by the mailroom are either forwarded directly to the cashiers or are given to Program Support for scanning into the CalEasi system. Though the cashiers do log the number of checks received from Program Support, there is no initial count to reconcile to."

DOC Response:

The Department implemented a change in process so that the Accounting Office is now responsible for logging in all license applications received with checks/money orders before routing them to program support (who then scans them into the CalEasi system).

Status:

During this FISMA review, we determined that this change was not functioning as intended; see the **Corrective Action Section** for our plan to resolve the issue.

Finding 07-2 Control of Receivables (originally DOF Finding 8)

“The Department does not perform write offs of outstanding receivables causing an overstatement of the account.”

DOC Response:

With the assistance of FSCU and the program managers, the Accounting Manager determined that the majority of delinquent account receivables were invalid. We developed procedures to write off uncollectible receivables and review the aging report monthly.

Status:

We found that the new procedures were not effective; valid receivables over 365 days were still uncollected.

Corrective Action Plan

The Department is in the process of implementing the corrective action plan as detailed in Attachment A. The Department has applied a temporary remedy for control of cash receipts until an overhaul of the current cashiering function can be developed. Accounting and various program units are collaborating to identify collectability of all outstanding receivables.

Conclusion

The Department is submitting its internal control certification for the two-year period ending December 31, 2007 in accordance with Government Code Sections 13400 through 13407 (Financial Integrity and State Manager's Accountability Act of 1983) as amended in 2006.

The Commissioner acknowledges his responsibility for the establishment and maintenance of the internal and administrative controls, and assuring that the systems function as prescribed within the Department. Based on the Department's review, the systems are functioning as prescribed except as previously indicated.

Name of
Department:

Department of Corporations

Date of Report: 12/31/2007

**CORRECTIVE ACTION PLAN
FOR INTERNAL CONTROL WEAKNESSES**

CONTROL WEAKNESSES IDENTIFIED	CORRECTIVE ACTIONS TAKEN	CORRECTIVE ACTIONS TO BE TAKEN	DATE OF ACTION/ PLANNED ACTION
Finding 07-01: Insufficient controls over cash receipts to ensure appropriate safeguards of the Department's cash collection or the reliability and integrity of data.	The mailroom routes all applications to the Cashier. The Cashier removes the check, replaces it with a photocopy, batches the applications, and forwards it to the Program Support Unit to scan into CalEasi. Meanwhile, the checks are held in the safe until the application and check appears in CalEasi. Then, the Cashier is able to deposit the check.	Streamline this process once a new IT Enterprise System is implemented within the Department.	September 2007/ New system - TBD
Finding 07-02: Inadequate controls over Accounts Receivable to ensure reliability and integrity of data.	The Department follows the required collection process pursuant to the State Administrative Manual. If not successful, a claim is submitted against the Licensee's surety bond for the amount due.		Ongoing
	The Accounting and various Program Units have been collaborating to determine the collectibility of all outstanding receivables, especially over 365 days. When all collection options have been exhausted, the Department prepares the necessary documentation to request a write off.		Ongoing